

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF PEAKS MILL WATER DISTRICT)
FOR AN ADJUSTMENT OF RATES PURSUANT TO) CASE NO. 2012-00008
THE ALTERNATIVE RATE FILING PROCEDURE)
FOR SMALL UTILITIES)

NOTICE OF FILING OF COMMISSION STAFF REPORT

Pursuant to the Commission's Order of February 23, 2012, Commission Staff files the attached report containing its findings and recommendations regarding the Applicant's proposed rate adjustment.



Jeff Derouen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED: MAR 30 2012

cc: Parties of Record

REPORT ON THE PROPOSED RATE ADJUSTMENT OF
PEAKS MILL WATER DISTRICT

CASE NO. 2012-00008

On January 9, 2012, Peaks Mill Water District ("Peaks Mill") filed with the Commission an application to adjust its current rates for water service. Using its historical operations for the calendar year ended December 31, 2010 and adjusting for known and measureable changes, Peaks Mill proposes rates that will produce additional revenues from water sales of \$130,307, an increase of 25.36 percent over normalized revenues from water sales. For a customer who purchases 5,000 gallons of water monthly, his monthly bill will increase from \$40.08 to \$50.57, or approximately 26.17 percent.

Commission Staff members Sam Bryant and Jason Green performed a limited financial review of Peaks Mill's test-year operations to determine whether test-period operating revenues and expenses are representative of normal operations and the proposed adjustments are reasonable.¹ They did not pursue and have not addressed in this report insignificant or immaterial discrepancies. Where they have not expressly addressed a test-period expense, they found insufficient evidence to contest the reasonableness of that expense.

This report summarizes Staff's review and recommendations. Mr. Green reviewed Peaks Mill's normalized revenue adjustment and proposed rate design. Mr. Bryant addressed all pro forma expense adjustments and the revenue requirement determination. Peaks Mill's pro forma operating income statement is set forth in

¹ Mr. Bryant and Mr. Green inspected Peaks Mills's records while assisting Peaks Mill in the preparation of its rate application.

Appendix A. In Appendix B, Commission Staff explains each of its proposed pro forma adjustments. Commission Staff's calculation of Peaks Mills's revenue requirements is shown at Appendix C. Commission Staff's recommended rates are found at Appendix D.

The Commission has historically used the Debt Service Coverage ("DSC") methodology to determine the revenue requirement for water districts and water associations. This approach is used primarily because a bond ordinance or loan agreement requires the water district or association to maintain a predetermined DSC level. Peaks Mill currently has outstanding bonds that Rural Development holds² and a long-term loan agreement with the Kentucky Infrastructure Authority.³ Commission Staff, therefore, recommends that the Commission use a debt service coverage ratio of 1.2 to determine Peaks Mill's revenue requirements. The Commission has previously found that this ratio is sufficient for a water association or district to cover its reasonable operating expenses, meet its debt service requirements, and provide for reasonable equity growth.

² See Case No. 96-091, *The Application of Peaks Mill Water District of Franklin County, Kentucky for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to the Provisions of KRS 278.023* (Ky. PSC Apr. 3, 1996). Approximately \$526,500 of these bonds remained outstanding as of December 31, 2010. *Report of Peaks Mill Water District to the Public Service Commission of Kentucky for the Calendar Year Ended December 31, 2010* ("Annual Report" at 23.

³ See Case No. 2006-00142, *Application of the Peaks Mill Water District for (1) A Certificate of Public Convenience and Necessity to Construct the Proposed Waterworks Improvement Project; (2) Approval of the Proposed Plan to Finance the Waterworks Improvement Project; and (3) Approval of the Proposed Increase In Rates for Water Service* (Ky. PSC June 28, 2006). As of December 31, 2010, the outstanding amount on this loan was \$911,804. *Annual Report* at 22.

Based upon its review, Commission Staff finds that Peaks Mill's pro forma operating expenses are \$523,405 and its debt service requirement is \$100,193.⁴ Using a debt service coverage ratio of 1.2x, Peaks Mill's total revenue requirement is \$641,607 and its total revenue requirement from water sales is \$617,865, an increase of \$127,594, or 26.62 percent above normalized revenue from water sales of \$487,957.

Commission Staff reviewed the billing analysis of Peaks Mill's test-period sales, which is contained in Peaks Mill's application, and concurs with the methodology and results of the analysis. Commission Staff finds that, based upon test-period sales, Peaks Mill's proposed rates, which are set forth in Appendix D, will produce revenues of \$617,937.

Neither Peaks Mill nor Commission Staff performed a cost-of-service study in this case. Commission Staff agrees with Peaks Mill's proposal that each rate block within the current rates be increased by an equal percentage derived from the percentage increase in revenue requirement over test-period normalized revenues. Accordingly, the rates set forth in Appendix D reflect an approximate 26 percent increase to each rate block of Peaks Mill's current rates.

Commission Staff recommends that Peaks Mill's proposed rates, as shown in Appendix D, be approved. While these rates will produce total revenues from water sales slightly greater than the recommended revenue requirement, the amount is very

⁴ This amount represents the average of Peaks Mill's annual principal and interest payments for the three-year period from 2012 to 2014.

small and materially insignificant.⁵ Moreover, adjustments to the proposed rates to produce the exact revenue requirement would require establishing rates that are beyond the capabilities of Peaks Mill's billing system. The proposed rates will allow Peaks Mill sufficient revenues to cover its reasonable operating expenses, service its debt, and provide for equity growth.

Signatures



Prepared by: Samuel J. Bryant, Jr., CPA
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis



Prepared by: Jason Green
Rate Analyst, Communications, Water
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Division of Financial Analysis

⁵ The proposed rates will produce \$62 in revenue in excess of the recommended revenue requirement. This amount represents 0.01 percent of the recommended total revenue requirement from water sales.

APPENDIX A
STAFF REPORT, CASE NO. 2012-00008
PRO FORMA OPERATIONS

Operating Revenues:	2010 Operations	Pro Forma Adjustment	Adj	Pro Forma Operations
Residential Sales	\$ 492,273	\$ (4,316)	(A)	\$ 487,957
Miscellaneous Service Revenue	<u>\$ 25,772</u>			<u>25,772</u>
Total Operating Revenues	\$ 518,045	\$ (4,316)		\$ 513,729
Water Expenses:				
Salaries and Wages	22,512	2,448	(B)	24,960
Salaries & Wages-	10,800	0	(C)	10,800
Employee Pensions & Benefits	2,813			2,813
Purchased Water	172,532	(41,023)	(D)	131,509
Purchased Power	11,936	(2,300)	(E)	9,636
Telephone		2,442	(F)	2,442
Chemicals	680	0		680
Accounting	7,024		(G)	7,024
Engineering		4,119	(H)	4,119
Legal	2,841		(I)	2,841
Contractual Services-Other	122,192	(71,912)	(J)	50,280
Repairs & Maintenance		67,793	(K)	67,793
General Liability Insurance	9,512	0		9,512
Postage		10,208	(L)	10,208
Rent	3,600	3,600	(M)	7,200
Other Insurance	1,447			1,447
Advertising	531			531
Bank Fees		2,300	(N)	2,300
Other	1,200	4,061	(O)	5,261
Miscellaneous Expenses	<u>19,011</u>	<u>(19,011)</u>	(P)	<u>0</u>
Total Water Expenses	\$ 388,631	\$ (37,275)		\$ 351,356
Depreciation Expense	156,796	12,132	(Q)	168,928
Taxes Other Than Income	<u>821</u>	0		<u>821</u>
Utility Operating Expenses	546,248	\$ (25,143)		<u>521,105</u>
Operating Income	\$ (28,203)	\$ 20,287		\$ (7,376)
Interest and Dividend Income	4,096	0		4,096
Interest Expense	<u>54,767</u>	0		<u>54,767</u>
Total Other Income and Expense	(50,671)			(50,671)
Net Income	<u>\$ (78,874)</u>	<u>\$ 20,287</u>		<u>\$ (58,047)</u>

APPENDIX B
STAFF REPORT, CASE NO. 2012-00008
PRO FORMA ADJUSTMENTS

A. Normalized Operating Revenues

Revenues have been normalized using the end-of-period customer level and the current rate. The adjustment reflects the results of Commission Staff's billing analysis and the current rate schedule.

B. Salaries and Wages-Employees

Peaks Mill has two employees. One employee works four days per week at a pay rate of \$12 per hour or \$384 per week (32 hours x \$12 = \$384), for an annual salary of \$19,968. (\$384 x 52 weeks = 19,968.). The other employee works eight hours per week at \$12 per hour resulting in an annual salary of \$4,992. (8 hours x \$12 x 52 weeks = \$4,992). Total employee salaries are \$24,960 (\$19,968 + \$4,992 = \$24,960).

C. Salaries and Wages-Officers and Directors

Peaks Mill's Board of Commissioners consists of three members. Each receives a monthly salary of \$300. Total annual salary is \$10,800 (3 x \$300 x 12 months = \$10,800).

D. Purchased Water Expense

807 KAR 5:066, Section 6(3) provides that "for rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations." Peaks Mills reported unaccounted-for water of 34.269 per cent for the test period. The cost of all unaccounted-for water in excess of 15 percent of total water purchased is unreasonable and should be disallowed. Commission Staff recommends that purchased water expense be decreased by \$41,023.

<u>Unaccounted for Water Loss Percentage</u>		
Water Produced/Purchased		93,957,000
Water Sales - Staff's Billing Analysis	9,371,500	
Water Treatment Plant	0	
System Flushing	2,387,000	
Fire Department	0	
Other	0	
Total Water Sold and Used		61,758,500
Unaccounted for Water Loss - Gallons		32,198,500
Percentage of Unaccounted for Water Loss		34.269%
Percentage Water Loss in Excess of 15 Percent		19.269%

<u>Determination of Pro Forma Purchased Water</u>	
Pro Forma Water Sales	59,371,500
Add: System Flushing, Fire Department, and Other	2,387,000
Subtotal	61,758,500
Divided by: 15% Line Loss Reciprocal	85.00%

Allowable Purchases/Production	72,657,059
<u>Purchased Water Cost per 1,000 Gal</u>	
Allowable Purchases	72,657,059
Multiplied by: Water Rate per 1,000 Gallons	\$ 1.81
Pro Forma Purchased Water Expense	\$ 131,509
Less: Actual Test-period Expense	(172,532)
Pro Forma Adjustment - Nonrevenue Water	\$ (41,023)

E. Purchased Power Expense

Peaks Mill reported Purchased Power Expense of \$11,936 for the test year. This amount was adjusted down by \$2,300 to Account for power used to pump excess unaccounted for water.

F. Telephone Expense

Peaks Mill reported telephone expense of \$2,442 in the Miscellaneous Expense account. It has been reclassified to Telephone Expense with a corresponding adjustment to Miscellaneous Expense.

G. Accounting Expense

For the test-year, Peaks Mill's accounting expense was reported at \$7,024. This amount was verified by invoices from the accountant for general accounting work and for preparation of the Annual Report to the Public Service Commission.

H. Computer Expense

Expenses for computer repair and support totaled \$4,119 and were verified by invoices from Software Solutions. This expense was initially recorded in Contractual Services and has been reclassified.

I. Legal Expense

Peaks Mill had legal bills that totaled \$2,841 for work done with financing authorities and the Public Service Commission.

J. Contractual Services-Other

This account has a test-period balance of \$122,192, which included amounts for a service contract, computer work and repairs and maintenance work. Gatewood Water Service ("Gatewood") has a contract with Peaks Mill to operate the water system for a fee of \$4,190 per month or \$50,280 annually (\$4,190 per month x 12 months = \$50,280). In addition Gatewood contracts with Peaks Mill to perform all repair and maintenance work on an hourly fee basis. All of Gatewood's fees are recorded in this account. All expenses, with the exception of the service contract have been reclassified. The amounts for repairs and Maintenance totaling \$67,793 and the amount for computer services of \$4,119 have been reclassified to respective accounts leaving a balance of \$50,280 in Contractual Services.

K. Repairs and Maintenance

The balance in this account was transferred from the Contractual Services-Other account. (See adjustment I). The majority of these expenses were for services performed by Gatewood and are supported by invoices provided by Gatewood.

L. Postage

Peaks Mill recorded \$10,208 for postage and shipping expense. This amount was recorded in Miscellaneous Expense. The amount was reclassified to this account.

M. Rent Expense

In early 2011, Peaks Mill moved into new offices. The monthly rent for these offices was \$600. The rent for its previous office was \$300 per month. The annual rent for its current office space is \$7,200 (\$600 per month x 12 months = \$7,200).

N. Bank Fees

Peaks Mill incurred bank charges of \$2,300. This amount was recorded in Miscellaneous expense. It has been reclassified to this account.

O. Other-Administrative Fee

Peaks Mill recorded \$4,061 for administrative fees paid to the Kentucky Infrastructure Authority. This amount was recorded in Miscellaneous Expense and has been reclassified to its proper account.

P. Miscellaneous Expense

This account was adjusted to a zero balance as a result of the reclassifications discussed above.

Q. Depreciation Expense

The utility added a total of \$642,893 in assets during the test period. Pumps, lines, and meters additions totaled \$533,700. These assets have a forty-year life with an annual depreciation expense of \$13,343. Peaks Mill expensed \$6,671 during the test year, making an adjustment of \$6,672 necessary. Peaks Mill also added additional meter testing equipment at an additional cost of \$109,193. Using a ten-year life, annual depreciation would be \$10,919. During the test year, depreciation expense of \$5,459 was taken, leaving an adjustment to depreciation expense of \$5,460. The total adjustment to depreciation expense is \$12,132.

APPENDIX C
 STAFF REPORT, CASE NO. 2012-00008
 DEBT SERVICE AND REVENUE REQUIREMENT

3-Year Average Debt Service			
<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 46,756	\$ 53,184	\$ 99,940
2013	48,957	51,555	101,512
2014	<u>50,290</u>	<u>49,836</u>	<u>100,126</u>
Total	\$ 146,003	\$154,575	\$ 301,578
3-year average			\$ 100,193

Revenue Requirement Calculation	
Adjusted Operating Expenses	\$521,105
Debt Service	100,193
.20 Coverage	<u>20,309</u>
Revenue Requirement	\$641,607
Less: Other Operating Revenue	<u>(25,772)</u>
Revenue Required from Rates	<u>\$615,835</u>

APPENDIX D
STAFF REPORT, CASE NO. 2012-00008
RECOMMENDED RATES

Monthly Rates For Water Service

First	2,000 gallons	\$ 25.41 minimum bill
Next	3,000 gallons	\$ 8.32 per 1,000 gallons
Next	5,000 gallons	\$ 7.14 per 1,000 gallons
All Over	10,000 gallons	\$ 5.97 per 1,000 gallons

Church Quarles
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